

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

RECEIVED

JUN 16 3 53 PM '00

POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

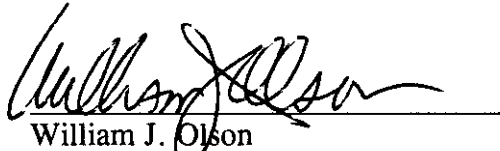
POSTAL RATE AND FEE CHANGES, 2000)

Docket No. R2000-1

RESPONSE OF ASSOCIATION OF PRIORITY MAIL USERS, INC.
WITNESS JOHN HALDI TO INTERROGATORIES OF
UNITED PARCEL SERVICE (UPS/APMU-T1-1-22)
(June 16, 2000)

Association of Priority Mail Users, Inc. ("APMU") hereby provides the following responses of witness John Haldi to the following interrogatories of United Parcel Service: UPS/APMU-T1-1-22, filed on June 2, 2000. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,



William J. Olson

John S. Miles

WILLIAM J. OLSON, P.C.

8180 Greensboro Drive, Suite 1070

McLean, Virginia 22102-3860

(703) 356-5070

Counsel for Association of Priority Mail Users, Inc.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with Section 12 of the Rules of Practice.



William J. Olson

June 16, 2000

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-1. In the case of each number shown in Table 1 of your testimony, provide complete citations for all of the data sources used to derive the number, including all calculations made to arrive at those numbers and all workpapers.

Response:

The Index, shown in columns 3 and 4, is computed from the unit cost data in columns 1 and 2.

The unit cost data for 1997 – 1999 are from the CRA (USPS version), page 1, column E (marginal cost per piece).

The unit cost data for 2000, 2001BR and 2001AR are derived from the following volume and cost data.

PRIORITY MAIL

<u>Year</u>	<u>Volume</u>	<u>Source</u>	<u>Cost</u>	<u>Source</u>
2000	1,229,818	USPS-32C, p. 1	2,754,964	USPS-14E, p. 7
2001BR	1,331,105	USPS-T-6, p. 5	3,263,396	USPS-32A, p. 1
2001AR	1,226,160	USPS-T-6, p. 5	3,064,062	USPS-32B, p. 1

PERIODICALS

<u>Year</u>	<u>Volume</u>	<u>Source</u>	<u>Cost</u>	<u>Source</u>
2000	10,397,195	USPS-32-C, p. 1	2,367,481	USPS-14E, p. 7
2001BR	10,434,523	USPS-T-6, p. 5	2,498,005	USPS-32A, p. 1
2001AR	10,321,166	USPS-T-6, p. 5	2,465,588	USPS-32B, p. 1

For 2001BR and 2001AR, the unit costs for Priority Mail that result from the above data are, respectively, \$2.452 and \$2.500. These unit costs are even higher than those shown in my Table 1, and the corresponding index numbers are increased accordingly, to 139 and 142, respectively. An errata will be issued shortly.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-2. Provide all references, reports, studies, and other documents on which you rely in support of the statement on page 11 of your testimony that "In the eyes of the consumer, performance is more relevant to the perception of value than any other factor save the rate paid."

Response:

This statement needs to be interpreted within the context of the immediately preceding sentence, which states that "[i]t is difficult to understand the Postal Service's objection to releasing data on PMPC performance on grounds of relevance." With this as predicate, it perhaps would have been better to have stated that "[i]n the eyes of the consumer, performance is more relevant to the perception of value than any other factor save, **perhaps**, the rate paid." In other words, to some consumers, perhaps many consumers, performance is even more important than the rate paid. Let me elaborate.

Priority Mail is but one of many expedited delivery services from which consumers can choose. Other services include, but are not limited to, Express Mail, FedEx and UPS overnight priority (*i.e.*, morning delivery), FedEx Standard (*i.e.*, afternoon delivery), and FedEx and UPS second day delivery. Each service offers the consumer a rate-performance combination. All of the preceding services have a higher price than Priority Mail, especially for individual shippers who pay the full, non-discounted rate, and the service commitment for each of these services is generally as high, or higher, than the service commitment of Priority Mail (the chief exception would be those areas where Priority Mail has an overnight commitment). Originators of packages and documents who

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

consciously elect to pay a higher price presumably value speed and consistency (*i.e.*, performance) even more than the rate paid. Those consumers who elect to use Priority Mail, which has a lower rate and less reliable performance than the other available services, presumably prefer the rate-performance combination of Priority Mail over that of the other expedited services. No studies were undertaken to arrive at this very obvious conclusion. In a marketplace with demonstrated aggressive competition in price and optional features, consumers shop for price and performance first, and other convenience and ancillary, optional factors second.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-3. Refer to page 11 of your testimony, where you state, "All indications of delivery performance point to the deterioration of service."

- (a) State precisely every indicator to which you are referring.
- (b) Define precisely the time period to which you refer.

Response:

(a) and (b). The statement which you quote was primarily in reference to the ODIS data cited in the preceding paragraph, which compared the 1995-1997 period with the 1997-1999 period.

In order to provide a more responsive answer to this interrogatory, as well as UPS/APMU-T1-4, I have prepared the tables shown in the attachment to the response to this interrogatory. These tables cover the period 1997 – 1999.

Using the PETE and EXFC data in Figure 1 and the ODIS data in Table 9 of my testimony, for the same period of successive years they compare (i) Priority Mail overnight and 2-day performance, and (ii) Priority Mail performance overnight and 2-day performance relative to First-Class performance with the same standard. In the latter comparison (i.e., Priority Mail vs. First-Class) the term "up" means that Priority Mail performance improved relative to First-Class, and the term "down" means that Priority Mail performance declined relative to First-Class (in the same quarter of the preceding year).

For overnight performance, Priority Mail performance in 1998, as measured by PETE, was worse in Q2 and Q3, but improved in Q4. As measured by ODIS, 1998 compared unfavorably with 1997. Relative to First-Class

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

performance, Priority Mail in 1998 also compared unfavorably to 1997 (with a slight improvement in Q4, however).

Priority Mail performance in 1999, as measured by PETE, was better in all four quarters. As measured by ODIS, 1999 registered a small improvement compared with 1998. Relative to First-Class performance, based on PETE data Priority Mail in 1999 also compared favorably to 1998 (with a some deterioration in Q4, however). Based on ODIS data, in 1999 Priority Mail performance relative to First-Class performance showed no change from 1998.

For second-day performance, Priority Mail performance in 1998, as measured by PETE, was worse in Q2 and Q3, but improved in Q4. As measured by ODIS, 1998 compared unfavorably with 1997. Relative to First-Class performance, PETE data show that Priority Mail in 1998 also compared unfavorably to 1997 (with a slight improvement in Q4, however). For the year, ODIS data are consistent with results based on the PETE data.

Priority Mail performance in 1999, as measured by PETE, was better in all four quarters. As measured by ODIS, 1999 registered a small improvement compared with 1998. Relative to First-Class performance, based on PETE data Priority Mail in 1999 also compared favorably to 1998. Based on ODIS data, in 1999 Priority Mail performance relative to First-Class performance showed no change from 1998.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

To sum up, Priority Mail performance in 1998 could be described as
"miserable," with some apparent improvement above that level in 1999.

OVERNIGHT PERFORMANCE

PRIORITY MAIL AS MEASURED BY PETE DATA

	1997	Performance vs. Same Period in Prior Year	1998	Performance vs. Same Period in Prior Year	1999	Performance vs. Same Period in Prior Year
Q1			84.85	n.a	90.73	up
Q2	85.99	n.a	82.73	down	88.15	up
Q3	88.22	n.a	88.16	down (flat)	90.69	up
Q4	85.99	n.a	91.26	up	91.37	up (flat)
Avg	86.73	n.a	86.75	flat	90.24	up

Source: APMU-T-1, Figure 1, p. 45.

PRIORITY MAIL, AS MEASURED BY ODIS DATA

86	n.a.	84	down	85	up
----	------	----	------	----	----

Source: APMU-T-1, Table 9, p. 50.

FIRST CLASS VS. PRIORITY MAIL (EXFC - PETE)

	1997	Performance vs. Same Period in Prior Year	1998	Performance vs. Same Period in Prior Year	1999	Performance vs. Same Period in Prior Year
Q1			8.01	n.a	2.05	up
Q2	4.76	n.a	9.93	down	5.00	up
Q3	3.93	n.a	5.35	down	2.85	up
Q4	6.36	n.a	1.76	up	2.37	down
Avg	5.02	n.a	6.26	down	3.07	up

Source: APMU-T-1, Figure 1, p. 45.

FIRST-CLASS - PRIORITY MAIL, AS MEASURED BY ODIS DATA

5	n.a.	8	down	8	flat
---	------	---	------	---	------

Source: APMU-T-1, Table 9, p. 50.

TWO-DAY PERFORMANCE

PRIORITY MAIL AS MEASURED BY PETE DATA

		Performance vs. Same Period in Prior Year		Performance vs. Same Period in Prior Year		Performance vs. Same Period in Prior Year
	1997		1998		1999	
Q1			69.50	n.a	82.53	up
Q2	70.75	n.a	60.77	down	66.21	up
Q3	77.11	n.a	75.86	down	80.00	up
Q4	71.69	n.a	82.88	up	84.62	up
Avg	73.18	n.a	72.25	down	78.34	up

Source: APMU-T-1, Figure 1, p. 45.

PRIORITY MAIL, AS MEASURED BY ODIS DATA

73	n.a.	72	down	74	up
----	------	----	------	----	----

Source: APMU-T-1, Table 9, p. 50.

FIRST CLASS VS. PRIORITY MAIL (EXFC - PETE)

		Performance vs. Same Period in Prior Year		Performance vs. Same Period in Prior Year		Performance vs. Same Period in Prior Year
	1997		1998		1999	
Q1			9.38	n.a	3.94	up
Q2	0.99	n.a	17.93	down	17.15	up
Q3	1.48	n.a	10.20	down	6.89	up
Q4	6.89	n.a	4.78	up	3.75	up
Avg	3.12	n.a	10.57	down	7.93	up

Source: APMU-T-1, Figure 1, p. 45.

FIRST-CLASS - PRIORITY MAIL, AS MEASURED BY ODIS DATA

9	n.a.	13	down	13	flat
---	------	----	------	----	------

Source: APMU-T-1, Table 9, p. 50.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-4. For every indicator identified in your response to interrogatory UPS/APMU-T1-3, state whether it shows that Priority Mail delivery performance has declined since the PMPC network has become fully operational.

Response:

See response to UPS/APMU-T1-3.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-5. Refer to page 14 of your testimony, where you state, "The failure to achieve significant performance improvement contributes to the erosion of the customer perception of the value of the Priority Mail service."

- (a) Provide all references, reports, studies, and other documents on which you rely to support this assertion.
- (b) Provide all references, reports, studies, and other documents on which you rely to support the assertion that there has been an "erosion of the customer perception of the value of the Priority Mail service."

Response:

(a) and (b). The above-quoted statement, which is the first sentence of a paragraph, is intended to be interpreted in the context of the remainder of the paragraph. As is well known, and as the balance of the paragraph points out, in the delivery business (and, indeed, as in other service businesses as well) one normally expects trade-offs between cost and the level of service. That is, one expects a higher level of service to cost more, while for a poorer level of service one would expect the cost to be less. Conceptually, there exists what might be referred to as the tradeoff "frontier" between cost and the level of service.

The Postal Service embarked on the PMPC "experiment" in order to improve service levels to its customers in the area served by the PMPC Network. If these levels have actually improved, it is not evident from the nationwide service performance levels that are being achieved. Consequently, no measurable tradeoff exists between the higher cost of the network and achieved service level improvements. The PMPC Network experiment thus has failed to represent a move along the tradeoff frontier. Instead, and despite the good

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

intentions of those who planned the PMPC Network, the Postal Service has moved to an "interior" point which clearly is inferior to other points along the efficient tradeoff frontier. To compare customer perceptions about various combinations along the tradeoff frontier, one would need some kind of market evidence or consumer survey. Under the circumstances here, however, my statement about customer perception is based on the fact that the Postal Service has moved to a more costly and less efficient outcome, and is not the result of a statistical survey or study.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-6. Refer to pages 19-20 of your testimony, where you state that "Should [the Commission] fail to recommend rates which the mailing public considers fair and equitable, a substantial portion of the remaining business will also migrate elsewhere." Quantify the "substantial" portion of Priority Mail business that will migrate elsewhere to which you there refer. In particular, indicate whether the migration you speak of is in addition to the migration predicted by Postal Service witness Musgrave's estimate of the own-price elasticity of demand for Priority Mail (see USPS-T-8, at 21).

Response:

When preparing my testimony, I did not attempt to quantify the "substantial" portion of Priority Mail that would be likely to migrate elsewhere.

With reference to the latter part of your question, however, it is intended that my reference to a "substantial" migration be interpreted as volume that would be lost in addition to the migration predicted by Postal Service witness Musgrave's estimate of the own-price elasticity of demand for Priority Mail. For further discussion on this point, see my response to UPS/APMU-T1-15.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-7. Refer to page 29 of your testimony, where you state that "Express Mail...could not under any foreseeable circumstances generate a major contribution to institutional costs." Provide all references, reports, studies, and other documents on which you rely in support of this claim.

Response:

At page 19 (lines 9-10) of my testimony, my mention of Express Mail includes a reference to Appendix A of my testimony. Although my testimony at page 29 did not expressly refer to Appendix A, perhaps it should have.

As shown in Appendix A, Table A-2 (page A-4), the highest contribution from Express Mail was recorded in 1984 (\$313 million). The 1998 contribution (\$219 million) was about 70 percent of that in 1984. If the 1998 contribution were to be adjusted for the inflation that has occurred over the intervening years, it would compare even less favorably.

It should be evident that the contribution which the Postal Service can obtain from a particular class or subclass is directly related to the cost, elasticity of demand and price charged for the service. The own-price elasticity of Express Mail, as reported by witness Musgrave (USPS-T-7, p. 41) is 1.57 (absolute value), the highest of any class or subclass of mail. Any increase in price above the existing level thus can be expected to result in a significant loss of volume and contribution. At the same time, as shown in my Table A-1 (page A-3), the markup on Express Mail established in the last rate case, Docket No. R97-1, was only 14 percent. Consequently, any significant reduction in the markup below the existing level would result in the risk of Express Mail not even

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

covering its attributable costs. With respect to Express Mail, the Postal Service (and the Commission) is thus "in a box." It cannot significantly increase rates on Express Mail without losing much of the small volume that remains, while any significant reduction in rates could result in revenues below attributable cost and consequent losses. These are the facts upon which I rely to conclude that in order for Express Mail to turn the corner vis-a-vis its contribution, it would need to generate much more volume than is presently foreseeable under any circumstances (except, perhaps, for a prolonged strike against FedEx or UPS, which presumably would be only a temporary phenomenon). No other specific documents were relied upon in support of this portion of my testimony.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-8. Provide all evidence available to you concerning whether the rates that Federal Express charges the U.S. Government are similar to the rates that Federal Express charges other mailers.

Response:

The government rates provided in Appendix B of my testimony are in the public domain, and were used as an example of what is actually available to large volume customers. It is my understanding that discounted rates for expedited delivery are widely negotiated by FedEx, UPS and other private sector competitors of the Postal Service. It is also my understanding that discounted rates in negotiated contracts are considered to be highly confidential and proprietary to the party furnishing such rates. Further, in many cases customers holding negotiated contracts are legally enjoined from disclosure of such information. Although such "secrecy" clauses are not typical of competitive industries, in the expedited delivery business they appear to be virtually universal. Accordingly, I have no evidence concerning whether the rates that Federal Express charges the U. S. Government for expedited delivery service are either similar to or much different from the rates that Federal Express (or any other private sector delivery provider, for that matter) charges other large volume shippers.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-9. Refer to the rates listed in Table 6 of your testimony.
For what time period are these rates guaranteed to remain in effect?

Response:

It is my understanding that the current contract between FedEx and GSA expires on August 15, 2000. However, the GSA has an option to extend the contract for one additional year, until August 15, 2001. Thus the rates are essentially guaranteed to remain in effect until this later date.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-10. Define precisely the term "somewhat low value of service" as you use it on page 39 of your testimony.

Response:

The statement means that when the weight limit for First-Class Mail was raised from 11 to 13 ounces, even at the \$3.20 rate the public perception of the value of Priority Mail was not sufficiently high to avoid a shift from Priority to First-Class Mail of an estimated 128 million pieces in Test Year (before rates; see LR-I-114, p. 3). That is, for some 128 million pieces, mailers prefer to save the difference between \$3.20 and the rate for 12 and 13 ounce First-Class Mail (\$2.75 and \$2.97, respectively); *i.e.*, the savings of only \$0.45 and \$0.23 has been proven to be sufficient to shift 128 million pieces from Priority to First-Class Mail when mailers have the ability to exercise that option.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-11. Define precisely the term “vastly more competitive marketplace” as you use it on page 40 of your testimony.

Response:

The phrase to which you refer, a “vastly more competitive marketplace,” is obviously a comparative phrase. I will try both to explain and illustrate it by reference to significant developments that have occurred since 1992. The market for expedited delivery service has become more competitive as a result of at least three major categories of change: (1) an increase in the range of offerings for expedited package and document delivery services by previously existing competitors; (2) the emergence of actual or potential new entrants in the expedited marketplace; and (3) the development of comparison shopping via the internet. Collectively, this means that consumers have better information as well as more choices, both of service providers and products. The following paragraphs elaborate on each of the above.

The expanded range of offerings and activities by previously existing competitors includes the new FedEx residential delivery service, Airborne@Home service, and UPS 3-day select service. It also includes the expansion of FedEx and UPS collection networks. A further development, driven by the increased competition and desire of the mailing/shipping public for better service at lower cost, has been the spread of long-distance team-driving and the expanded range of 2- and 3-day delivery that can be achieved by surface transportation, which has a somewhat lower cost than air transportation.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

Actual or potential new entrants include the emergence of major European postal administrations as privatized or corporatized global operators. This includes the pending privatization of Deutschpost AG and its investment in DHL (as well as other companies in the delivery business around the world), the purchase of TNT by the Dutch Post Office (which has been privatized and now has listed on the NYSE American Depositary Receipts, which are the equivalent of shares of stock for foreign firms), and the potential entry of Royal Mail into the domestic market (Royal Mail, which has been corporatized but not privatized, has recently purchased a majority interest in a private sector delivery company in Sweden, signaling its intent to expand beyond Great Britain).

The Internet, increasingly utilized as a facile place to conduct comparison shopping, now provides visibility and "one stop shopping" for expedited delivery services, and allows purchasers of such services to make more informed selections concerning the price and value of offerings by all competitors in this field (see Appendix C of my testimony for more information on this point).

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-12. Refer to page 40 of your testimony, where you state that (a) "at minimum, the drop in volume growth from 10 percent in 1990 to 2 percent in 1991 will likely recur with any rate increase of the magnitude proposed by the Postal Service" and (b) "recovery of lost volume and market share will be much more difficult, if not impossible, to achieve." Provide all references, reports, studies, and other documents on which you rely in support of these claims.

Response:

(a) The above-quoted statement refers to a year-to-year decline in volume growth from 10 percent to 2 percent, or a net decline in one year of 8 percent.

The year-to-year Priority Mail volume figures for the years 2000 and 2001 are as follows:

<u>Year</u>	<u>Volume (000)</u>	<u>Percent change</u>
2000	1,229,818	
2001BR	1,331,105	8.2%
2001AR	1,226,160	-0.3%

In the absence of a rate change, the volume in 2001 Before Rates is forecast to increase over the year 2000 volume by about 8.2 percent, and if the Postal Service's rate increases are adopted as proposed, the volume in 2001 After Rates is forecast to decline from the year 2000 volume by about 0.3 percent. The net result of the rate increase is thus forecast to reduce volume growth from what it otherwise would have been by about 8 percent.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

(b) Historically, the Postal Service has found it difficult to regain market share lost to private sector competitors. The two outstanding examples of this are parcel post and Express Mail. At one time the Postal Service was the dominant provider of each service. Today it has a minor share of each market, and its role has been reduced to that of a niche participant, catering to the small segment that does not use a private sector competitor, but instead still relies on the Postal Service. In addition to these historic facts, competition in the expedited delivery market has become more intense since 1990-1992; for further discussion on this point see my response to UPS/APMU-T1-11.

As my testimony points out, Priority Mail competes primarily as a low cost entry in the market for expedited package and document delivery services because it lacks many of the added value features of competitors' products. It should not take a specialized study or even a market place survey to understand that an erosion of the pricing advantage enjoyed by Priority Mail, will lead customers to select from among the many other providers who offer added value features and performance guarantees not currently available with Priority Mail. For additional discussion concerning the problems which the Postal Service may encounter in any effort to regain lost market share, see my response to UPS/APMU-T1-15.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-13. Provide the original source of the market share statistics in Table 8 of your testimony and explain how they were calculated. In particular, indicate whether identical definitions of "the market," "pieces," and "market competitors" were employed in every year cited in Table 8.

Response:

All data contained in Table 8 were originally provided by the Postal Service, including the data cited by the Commission in its *Opinion and Recommended Decision* in Docket No. R94-1. It is my understanding that the Postal Service obtains the data via a contract which it has with the Colography Group, which would know whether the definitions you seek have been consistently employed in every year cited in Table 8. With respect to the consistency of the underlying definitions, I could not even speculate, because I do not have any relationship or contact with the Colography Group.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-14. Explain the discrepancy between the 62.4% market share for Priority Mail in 1998 reported in Table 8 and the corresponding 61.8% market share reported in footnote 41 of your testimony.

Response:

Each datum you cite in this interrogatory was provided by the Postal Service, as indicated by the references provided in my testimony. I would suggest that this interrogatory is more appropriately directed to the Postal Service for clarification.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-15. Provide all references, reports, studies, and other documents on which you rely to support the view expressed on page 42 of your testimony that the validity of witness Musgrave's forecasting model would be called into question if Priority Mail rates were to rise above the rates charged by competitors.

Response:

Witness Musgrave's forecast is based on the traditional econometric model. This method uses *available* historical data to analyze relationships as they have existed between specified variables. In this regard, it should first be noted that witness Musgrave's model does not contain any variable for the price of the closest competing substitutes – *i.e.*, 2-day delivery services offered by Airborne, FedEx, UPS or other competitors – because reliable pricing data for such services are not available; see my response to UPS/APMU-T1-8. Clearly, therefore, the model does not even incorporate the critical relationship between rates for Priority Mail and prices of competing 2-day delivery services.

When an econometric model such as that presented by witness Musgrave is used for forecasting, it is assumed that (i) the most critical structural relationships have been captured by the model, and (ii) those relationships will continue to exist in a relatively stable form, and hence will be a useful, somewhat reliable guide to future outcomes, assuming that the independent variables can be forecast with reasonable accuracy.

Aside from the failure to capture what may be the most critical relationship of all (*i.e.*, the price of competing 2-day delivery services), many commonplace

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

market phenomena apparently are characterized by more complex behavior, comprised of both competitive and restrictive elements, that arise as the result of nonlinear spatio-temporal interactions among a large number of components or subsystems. Six features of such systems include: (i) dispersed interaction; (ii) absence of a global controller; (iii) cross-cutting hierarchical organization with many channels of communication and tangled interactions; (iv) continual adaptation; (v) perpetual novelty; and (vi) system adjustment through out-of-equilibrium dynamics.¹ Of particular importance for the question posed here is the finding that market responses in complex economic systems may have critical points between stable zones where convergent behavior dominates, and turbulent zones where search behaviors and "bandwagon" effects lead to more complicated dynamics.²

In terms of Priority Mail rates, as observed from the point of view of the Postal Service, it is unsafe to assume that the stable, convergent behavior of current Priority Mail customers that is described by witness Musgrave's forecasting model will continue to hold for rate increases of arbitrary magnitude. The model makes two critical assumptions that are likely to break down at the

¹ J. Barkley Rosser, Jr. (1999) Review of *The Economy as an Evolving Complex System II*, edited by W. Brian Arthur, Steven N. Durlauf, and David A. Lane, Santa Fe Institute Studies in the Sciences of Complexity Proceedings Volume XXVII, Addison-Wesley, Reading, Massachusetts, 1997; in *Discrete Dynamics in Nature and Society*, vol. 3, no. 1, pp. 71-74.

² *Ibid.* See < <http://www.econ.iastate.edu/tesfatsi/ace.atm> > for a more complete bibliography.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

boundary of the turbulent zone. The model assumes that (i) small changes in Priority Mail rates will call forth similarly small changes in Priority Mail volume; and (ii) changes are reversible, that is, that any loss of volume provoked by a Priority Mail rate increase can be made good by a rate decrease of equal magnitude. If the rate increase carries the system into the turbulent zone, however, all bets are off. Widespread structural adjustments among Priority Mail customers may take place, shifting usage massively and irreversibly toward commercial competitors. Thus, slight errors in demand management could well lead to greatly increased economic instability for the Postal Service.³

To be sure, no one knows at precisely what point a Priority Mail rate increase will cross the boundary into the turbulent zone. Prudent management of the Postal Service would thus counsel against avoiding any rate increase that might cause Priority Mail rates to exceed the unpublished, discounted rates charged by competitors.

³ David Parker and Ralph Stacey. *Chaos, Management and Economics: The Implications of Non-Linear Thinking*. 1998: London, The Institute of Economic Affairs. Executive Summary.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-16. Define "poor performance" as you employ the term on page 43, line 6, of your testimony, and explain how the absence of a track and trace service "hides" poor performance.

Response:

In my view, delivery performance should be assessed in at least two complementary ways: (1) performance against a standard (*e.g.*, actual days to deliver versus the standard number of days for delivery), and (2) for those pieces that fail to receive timely delivery, one or more indications of the dispersion and extent of failure (*e.g.*, the actual distribution of days late, or average number of days late).

"Poor performance," as employed in the portion of my testimony referenced in your interrogatory, can mean either an unfavorable comparison with the preset standard (the first measure), or, for those pieces that fail to receive timely delivery, a high dispersion from the standard, indicating highly inconsistent and unreliable delivery when the standard is not met (the second measure).

The absence of a track and trace capability hides poor performance from both customers and managers as explained below. It is especially critical for those pieces that receive untimely and inconsistent service. For customers, if a track and trace capability were in place for Priority Mail, they could dial a service line or access a web site, present the tracking number, and determine where the mail piece was last handled, on a real time basis. Absent this feature, customers have no way to obtain current Priority Mail status. At best, the Postal Service

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

provides information only after the fact (*i.e.*, after delivery has occurred), and then not routinely for all pieces, but only when the customer has explicitly signed up for delivery confirmation service. Neither customers nor Postal Service managers have any in-transit information that signal failures in handling or transportation on the part of the Postal Service. When pieces are several days late, customers may worry that the piece has been lost, and the Postal Service has no information whatsoever that may placate the customer. For managers, delivery confirmation (when customers elect to use it) will enable the Postal Service to develop data on the extent of service failures and generally identify the existence of problems, but it will neither pinpoint where problems have occurred within the network, nor will it facilitate more effective management; *i.e.*, the source of the problem is hidden from managers.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-17. Define precisely the term "outperformed" as you employ it on page 44, line 12, of your testimony.

Response:

Outperformed, as used here, means that since 1997 service achievement scores for First-Class Mail have exceeded the corresponding achievement scores for Priority Mail in every quarter for which data are available.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-18. Using the data presented in Figure 1 of your testimony, confirm that Priority Mail has achieved its service standards more consistently in 1999 than in 1998, when measured on a quarter-to-quarter basis. If you do not confirm, explain why you do not do so.

Response:

Confirmed.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-19. Define the term “on time” as you employ it on page 44 of your testimony, and explain why it is necessarily the case that the “bottom line” for mailers is whether the mail is delivered “on time”, as you define it.

Response:

The term “on time” as it is used here refers to meeting the Postal Service’s committed delivery standard for Priority Mail.

Mailers who elect to use Priority Mail expect the Postal Service to provide delivery that is both timely and consistent vis-a-vis the Postal Service’s stated standards, just as they would with other major vendors who provide competing expedited delivery products that, usually, are more expensive. So long as Priority Mail achieves timely delivery, mailers neither care nor are aware whether (i) their pieces are processed separately from or jointly with First-Class Mail, or (ii) whether their mail is processed in a new PMPC or a plain old plant (POP), or (iii) whether their mail travels via surface or air, or (iv) whether their mail travels on the Eagle Network or via commercial airlines. If the mail receives timely delivery, mailers receive the value which they expect for their money. And if the mail fails to receive delivery that is timely and consistent, these other indicators of “intrinsic value” do little or nothing to assuage any sense of frustration and disappointment, or to compensate for lost value. When packages are delivered on time, delivery confirmation is a helpful ancillary service insofar as it enables mailers to ascertain that the piece was delivered. Until the piece is delivered, however, delivery confirmation has nothing to report.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-20. Confirm that the discussion in lines 1-4 on page 49 of your testimony implies that "customer expectations" about service performance, and not service performance alone, affect "value of service." If you do not confirm, explain why you do not do so.

Response:

Confirmed.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

UPS/APMU-T1-21. Refer to page 53 of your testimony, where you state that Priority Mail's delivery performance "is generally perceived as less timely and reliable than its competitors." Provide all references, reports, studies, and other documents on which you rely in support of this claim.

Response:

To the best of my knowledge, competing providers of expedited delivery service do not publish any data, reports or studies on the extent to which they either achieve, or fail to achieve, their own delivery standard. Consequently, it is not possible to make objective comparisons between Priority Mail performance and that of competing services. It is for this reason that one must deal in perceptions about Priority Mail and competing services.

As regards the failure of Priority Mail to achieve its own performance standards, the performance data that were provided by the Postal Service and are contained in my testimony speak for themselves. In addition, Priority Mail carries no guarantee of delivery by a specific time or on a specific day. Other entries in this market segment do provide such commitments. The net effect of these differences is that Priority Mail is perceived as less timely due to that lack of specificity on its part versus "guaranteed" service by competitors. Aside from numerous anecdotal "horror stories" about very late and inconsistent delivery, which I hear from large Priority Mailers by virtue of my position as economic counsel for APMU, I have not relied on any studies or reports to validate my statement concerning perceptions about Priority Mail.

APMU Witness John Haldi Response to Interrogatory of
United Parcel Service

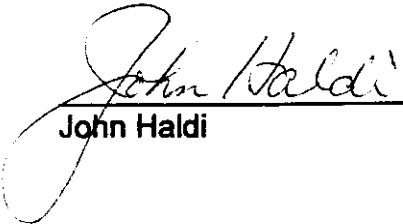
UPS/APMU-TI-22. Confirm that, based on the data presented in Table A-2 of your testimony, in FY1998 Priority Mail's contribution to institutional costs was at its lowest level since FY 1994.

Response:

Confirmed.

DECLARATION

I, John Haldi, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.


John Haldi

Dated: June 16, 2000